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Vietnam: The Communists initiated no significant military action on 31 July - 1 August.

Sharp ground fighting broke out in the western delta at South Vietnamese initiative for the second day in a row. Communist units in this area are offering stiff resistance to government sweeps and are taking fairly heavy casualties.

The Communists are maintaining supply movements through the Laotian Panhandle in spite of heavy rains and air strikes. With the rainy season currently in full swing, North Vietnamese trucks continue to move toward supply bases in South Vietnam at about the same moderate level as last year. Traffic has fallen off during the past few months from the high levels previously detected, but the average of 21 trucks a day for June and 13 for July is comparable to daily averages a year ago.

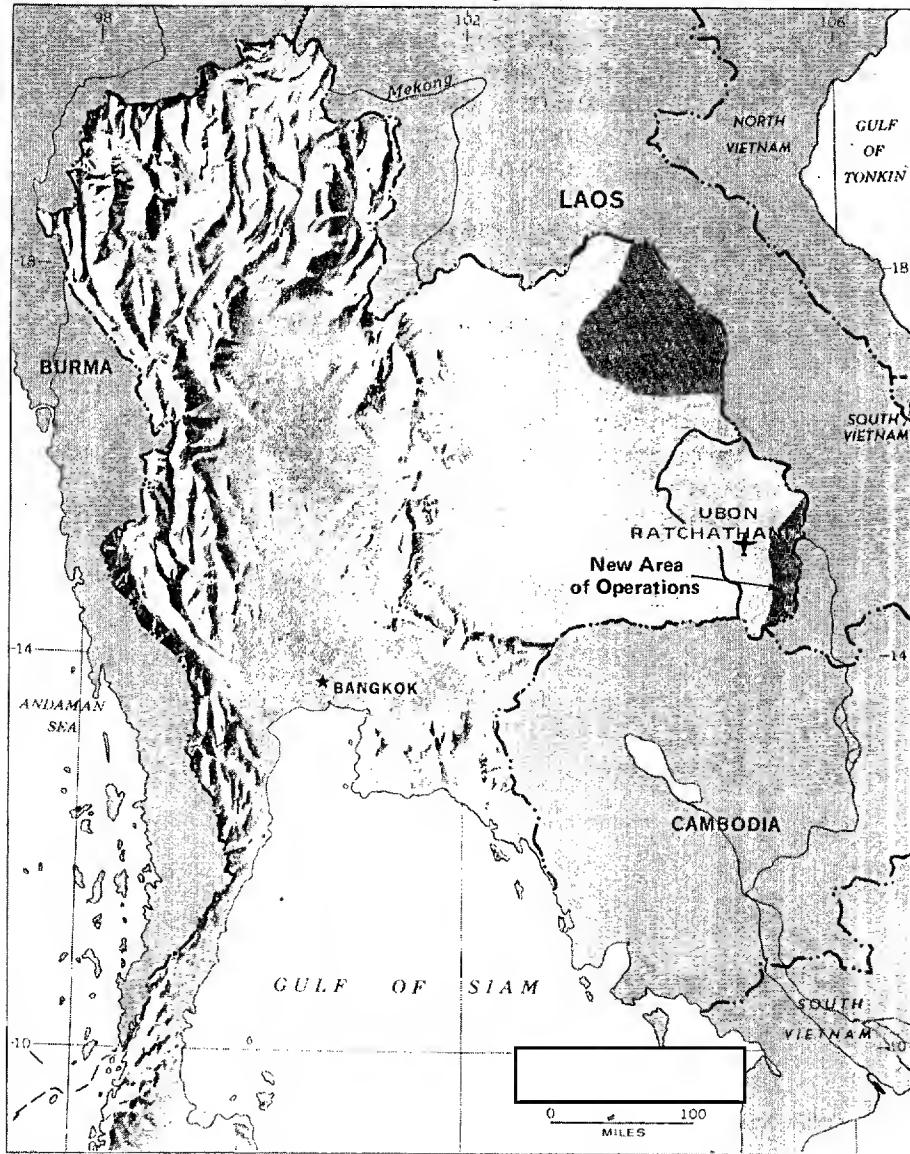
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Communists Setting Up New Insurgency Area in Thailand



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Thailand: Communist insurgents may be planning to set up a new area of operations in the northeast.

[REDACTED] since early this year perhaps as many as 200 North Vietnamese - trained cadre have been infiltrated across the Laotian border into southern Ubon Province. The capture of some modern weapons, the recent attack on the Ubon air base, and [REDACTED]

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[REDACTED] Communist proselytizing could be harbingers of a substantial insurgent effort in southern Ubon. Such an effort would be facilitated by Ubon's proximity to Communist bases in Laos and by the familial and other ties of many people on the Thai side of the border to Lao Communist elements.

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There is no evidence to indicate what the Communists expect to achieve if they do establish a new area of operations. They may hope that southern Ubon can be developed into a firm foothold for further expansion in the strategic northeast region. They have been trying for several years to build a viable organization in other northeast areas but have not made much progress.

One reason for the Communists' difficulties has been the actions of the Thai Army, which has pressed them hard, particularly in the northeast. There is some evidence, however, that the army now wants to cut back its effort in this area. The army's chief of staff reportedly has seized on the deteriorating situation in Laos as an excuse to put into effect contingency plans calling for the partial withdrawal of army units engaged in the counterinsurgency effort. If such a withdrawal takes place, it would give the insurgents a respite from government pressure.

The government, meanwhile, has once again restructured its counterinsurgency apparatus. A Communist Suppression and Prevention Command has been established under the direct control of Deputy Prime

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Minister Praphat. Aside from further strengthening Praphat's voice in Thai affairs and ostensibly "regularizing" the counterinsurgency effort, it is not yet clear what this new setup will accomplish.

[REDACTED]

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Cambodia: Sihanouk's recent threat to step down as chief of state apparently was designed to pave the way for major policy and personnel shifts.

Sihanouk told the national congress on 31 July that he would soon form a new government that would be charged with the responsibility of meeting Cambodia's severe economic difficulties. He emphasized that the state of the Cambodian economy called for strong and unpopular measures and that the new government would have to display the fortitude to see that such measures were carried through.

In order to underline the gravity of the situation, Sihanouk once again threatened to turn over the reins of government to others. Although partly reflecting his frustrations in trying to cope--almost singlehanded--with nagging and seemingly insoluble problems, Sihanouk also uses such warnings to remind domestic critics that there is no palatable alternative to his rule or his policies.

In discussing possible arrangements in case he steps down, Sihanouk went a bit further than he has in the past, but he also made it clear that he has no intention of surrendering at any early date his control of Cambodia's affairs. Although the tenor of Sihanouk's speech demonstrates his growing concern over the government's perennial budget deficit, the declining production and export of rice, and the general economic malaise, he gave no hint of what particular steps might be taken to help alleviate the situation.

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El Salvador - Honduras: Salvadoran troops have begun to withdraw from Honduran territory, but the continuing arrival in El Salvador of war materiel casts grave doubts on the country's long-range intentions.

The most recent Salvadoran acquisition is a B-26 bomber--the first to be owned by either of the two antagonists. [REDACTED]

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Salvadoran troops began leaving a few Honduran towns on 30 July, [REDACTED] they are taking with them transportable items of value and destroying much that they cannot carry.

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[REDACTED] bridges and roads have been mined and houses booby-trapped.

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In contrast to the euphoria prevailing in El Salvador, disappointment and bitterness--especially toward the OAS--are evident at all levels of Honduran society. The Honduran people have been surprised and shocked to learn that the Salvadorans were not declared aggressors or penalized in any way, and many officials consider the US responsible for the "unsatisfactory" outcome of the negotiations. The Nicaraguan, Guatemalan, and Costa Rican ambassadors to Honduras have already expressed concern about the increasing expressions of popular hatred toward El Salvador and are worried about the danger this presents to Central America. [REDACTED]

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Argentina: The run on the peso triggered by domestic political uncertainties appears to have ended.

By early July, capital outflow had dropped to a level normal for this time of year, following the unusual \$100-million foreign exchange loss in May and June. The crisis in confidence--caused by widespread social and political unrest--had compelled large Central Bank sales of foreign exchange to meet increased market demand. Seasonally low exports and the high level of imports required by a rejuvenated economy contributed to the exchange loss. Perhaps more important, the Central Bank had lowered interest rates in May, shortly before the announced increase in rates in the US and Eurodollar market.

While the run on the peso shows that the confidence created by the accomplishments of the Onganía government is vulnerable, Argentina's large foreign reserves provide reasonably strong protection. Even at their low point at the end of June, gross foreign reserves were more than adequate at \$784 million. Receipt on 29 July of half of a new \$50 million loan from five US banks will add to reserve strength and demonstrate continued foreign confidence. The government's acceptance of tight credit terms, however, reflects its unwillingness to attempt to sell bonds abroad at a time of political trial.

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Brazil: Dissension over the draft constitution could cause new troubles for President Costa e Silva. Key military ministers and the hard-lining justice minister are pushing for tougher provisions, including more executive control over Congress, increased powers for military courts to try civilians, and wider presidential authority to issue decree laws. Costa e Silva will probably have to accede to their demands rather than let them force the issue in the National Security Council where a defeat could jeopardize his position. [REDACTED]

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Italy: Premier Rumor told President Saragat yesterday that he has been unable to form a new government within the limits set by the President and his own Christian Democrats. These limits permit support neither from the Communists nor from the extreme right parties. Should the impasse persist, Saragat may name a caretaker government and call for parliamentary elections this fall. [REDACTED]

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Congo (Kinshasa): An extensive cabinet reshuffle yesterday may reflect President Mobutu's growing confidence in his own political position. Among others, Mobutu dropped Foreign Minister Bom-boko and Finance Minister Nendaka, two of his most capable ministers but also two of the few Congolese with political strength and prestige in their own right. With presidential elections coming in about a year, Mobutu might have viewed these men as potential candidates and have been anxious to get them out of the limelight. [REDACTED]

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